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Resolution of Cross-border Banking Groups: Challenges and Proposed Remedies

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What's the problem

- Globalized (too-big-to-fail) institutions -GSIFs
- Highly interconnected
- Operating the group as a single business although many parts of the business will be separately incorporated and subject to the principle of separate legal personality
- Labyrinthine corporate structures
- Local laws have local reach
- Who bears the cost?
- there is no global treaty or a global burden sharing arrangement

Why A Special Resolution Regime?

- General insolvency law unable to deal with bank resolution: insolvency law aims at the fair treatment and maximization of creditor recovery
- General insolvency law entails lengthy negotiations
- bank resolution aims at minimization of disruption to the financial system and continuity of operations
- It minimizes the influence of private parties' rights (creditors; shareholders)
- And reduces the scope for judicial recourse
- Provision of liquidity is of essence
- Resolution options limited as a speedy breaking up or business sale might not do

Two (and a half) approaches to Group Resolution

Territoriality	Cooperative Territorial approach / Modified Universality ('Middle approach')	Universality
<p>Each national jurisdiction applies its own law which governs insolvency proceedings for the entities, operations, and assets of the insolvent firm located in that jurisdiction.</p> <p>This protects national sovereignty and authority, but is normally done so at the expense of its cross-border banking partners.</p>	<p>Recognises the strong possibility of ring fencing in a crisis and helps ensure that home and host countries and financial institutions focus on resiliency within national borders. (where they can try to align their toolbox vis-à-vis improving their legal systems)</p> <p>Such an approach may require certain discrete changes to national laws and resolution frameworks to create a more complementary legal framework that facilitates financial stability and continuity of key financial functions across borders. This approach aims at improving, inter alia, the ability of different national authorities to facilitate continuity in critical cross-border operations.</p>	<p>Resolutions of insolvencies based on the law of a single country where the home entity is established⁴⁵. Under this option, the decisions of the resolution authority in the home country jurisdiction is extended to branches, other operations and assets of the insolvent firms in other jurisdictions.</p>

Source of information: BCBS Report, March 2010

Obstacles to Cross-border Group Resolution

- In the absence of an International Treaty all approaches raise issues of:
- (at the least) Minimum harmonization of National Resolution rules
- Coordination – Establishment of Coordination Procedures
 - Leadership?
 - Communication
- Building Institutional Capacity to Implement an International Solution
- The Funding of cross-Border Resolution.

Why fragmentation of global banking matters?

- Ring-fencing is the only 'bullet proof' solution under the circumstances but it harms cross-border banking
- BUT
- Retrenchment into national borders (ring-fencing measures and substantial cutbacks in cross border activities) carry high economic costs and risks,
- It strains the relations between home and host authorities, especially in countries like emerging Europe, where foreign banks typically dominate local banking systems.
- Also it destroys group synergies and economies of scale

FSB's Key Attributes

- Constitute 'soft' harmonization attempt
- They seem to be widely heeded
- They supply a concrete framework for (national) Special Resolution Regimes which provides for:
 - Establishment or specification of the competent Resolution authority
 - Establishment of Clearly Defined Resolution powers
 - Set-off, netting, collateralisation, segregation of client assets
 - Specified Mechanism for Funding of firms in resolution
 - Safeguards

FSB Key Attributes

Cross-border co-operation

- Legal framework conditions for cross-border cooperation – necessitating MoUs between national resolution authorities
- Crisis Management Groups (CMGs)
- Institution-specific cross-border cooperation agreements
- Resolvability assessments
- Recovery and resolution planning
- Access to information and information sharing.

The Role of Recovery and Resolution Plans

- Drawing up of Recovery and Resolution Plans (so-called Living Wills) and their approval for systemic banks by both home and host authorities is an important tool in cross-border supervision and resolution of banks.
- They provide an ex ante map of corporate structures and asset and liabilities' distribution around the group as well as early indication where the most risky operations of the group are located and a description of those risks which is not entirely static, as RRP's have to be regularly updated.
- But there are conflicts of interest, where for instance a parent bank and home supervisor may have incentives not to show or set up the recovery plans together with the host supervisors.
- RRP's gain in credibility if they are discussed and approved by all countries where the relevant bank plays a systemic role, and admittedly this problem will probably not arise at least in MoUs between developed country regulators .

BUT

- Too much hinges on trust in terms of resolution authority cooperation and MoU effectiveness
- In the absence of legally binding bilateral/multilateral burden sharing arrangements the effectiveness of MoUs will be severely tested under conditions of crisis
- Cross-border spillovers from regulatory/supervisory actions. In crisis situations, capital or liquidity or both are usually in short supply – or thought to be
- Host countries may feel the need to restrict the operations of bank subsidiaries under their jurisdiction, particularly if these subsidiaries are of systemic importance.
- There needs to be agreement ex ante about the practical tools in crisis management, such as limiting dividend payments, requiring more capital (locally or by parent), raising liquidity requirements etc. and certainty that such agreement will be adhered to.

Resolution Techniques for Cross-border Groups

- Contemporary resolution strategies for cross-border group under development are broadly based around two 'stylised' approaches, Single Point of Entry (SPE) and Multiple Points of Entry (MPE).
- Under an SPE strategy, resolution tools are applied to the non-viable bank's holding company or parent entity. As a result, losses would be absorbed and the Group recapitalised without interfering with the operations of the Group's subsidiaries.
- Namely, In SPE, losses in subsidiaries are transferred to the parent company. If this becomes insolvent, it is bailed inThis requires that an appropriate quantity of bail-in-able liabilities are issued at the parent holding company level. Such an approach is significantly simplified if the parent holding company does not book or otherwise contain any of the Group's operational assets.

MPE

- MPE involves two or more resolution authorities applying resolution tools to multiple parts of a group, and “is likely to result in a break-up of the group into two or more separate parts”, along a national, regional, or business-lines basis, particularly if a “distressed part of the group” needs to be detached. The healthy parts are either sold or become a “residual group”, while the diseased parts are individually bailed in.
- This requires preferred resolution strategies to be articulated for each part of the group that may be separately resolved
- The FSB has emphasised that “there is no binary choice between the two approaches” and that “in practice, a combination might be necessary to accommodate the structure of a firm and the local regimes in the key jurisdictions where it operates.”

SUPERVISORY COOPERATION UNDER SPE & MPE

- Paul tucker, BoE: Under an SPE approach relatively little co-operation is required, but the home authority must be sufficiently credible to ensure that host authorities "refrain from taking independent action", although hosts could provide assistance as necessary.
- Under MPE, co-operation becomes more important. Each key host authority needs to be open about its plans, and the home authority needs to do the same, "ensuring a joined-up, collaborative approach with no surprises", (Paul Tucker, BoE, 2013).
- Some supervisors, such as those in the UK and US, have established plans to co-operate on resolution, but most are still negotiating.
- However, over recent months there has been a marked convergence in how the world's key authorities plan to approach resolution

Some conclusions

- Resolution is closely tied to supervision. Cooperation in the supervisory colleges has in some cases been held back by lack of agreement on how to handle the resolution of a cross-border bank.
- One potential hindrance to reaching ex-ante agreements on resolution is the parties' reluctance to share sensible information, a problem which could possibly be overcome by reducing the size of the resolution committees.
- The role of the host supervisors must be strengthened. How can a host country be expected to participate in a resolution of a bank if it has not been given sufficient information of the whole bank group and also been given a chance to influence its supervision?
- Aligning the incentives of supervisors and resolution authorities is a key objective. In the Eurozone, this is done through a joint resolution authority for the big cross-border banks and a joint resolution fund.
- Resolution funds may also need to be set up domestically and coordinated across borders so as to support common interest without unduly compromising fiscal authority.

Some Conclusions

- Identifying systemic parts of relevant cross-border banking groups and confining the efforts to those parts may also be a way forward in cross-border cooperation. The RRP's may help in this respect.
- If no results in cross-border cooperation are attained, the fall-back solution is always to split a bank in trouble along country borders.
- BUT
- Such an approach would seriously damage franchise value as it happened in the cases of Fortis and to some extent Dexia